



Mary Taylor, CPA
Auditor of State

LORAIN COMMUNITY SCHOOL
CUYAHOGA COUNTY

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Mary Taylor, CPA

Auditor of State

INDEPENDENT ACCOUNTANTS' REPORT

Lorain Community School
Lorain County
201 West Erie Street
Elyria, Ohio 44052

To the Board of Trustees:

We have audited the accompanying basic financial statements of the Lorain Community School, Lorain County, Ohio, (the School) as of and for the year ended June 30, 2006, which collectively comprise the School's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require that we plan and perform the audit to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lorain Community School, Lorain County, Ohio, as of June 30, 2006 and the changes in financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2007, on our consideration of the School's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information Governmental Accounting Standards Board requires. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measuring and presenting the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Mary Taylor". The signature is written in a cursive, flowing style.

Mary Taylor, CPA
Auditor of State

March 22, 2007

LORAIN COMMUNITY SCHOOL LORAIN COUNTY

Management's Discussion and Analysis For the Fiscal Year Ended June 30, 2006 Unaudited

The discussion and analysis of Lorain Community School's (the School) financial performance provides an overall review of the School's financial activities for the fiscal year ended June 30, 2006. The intent of this discussion and analysis is to look at the School's financial performance as a whole. Readers should also review the Notes to the Financial Statements and the Financial Statements to enhance their understanding of the School's financial performance.

Financial Highlights

Key financial highlights for 2006 include the following:

- In total, net assets increased \$189,089, which represents a 50.2% increase from 2005. This increase is due primarily to increased efficiencies in operating the school. During the year grades 5 through 8 were split off into a new middle school. This change created a decrease in state funding and federal subsidies based on enrollment, and, an increase in rent and service income from the new middle school. Also, private grants were received during the year.
- Total assets increased \$205,600, which represents a 49.7% increase from 2005. This increase is due to an increase in the year end cash of \$162,772 and an increase in current assets of \$259,399 offset by a decrease in net capital assets of \$53,799. The cash balance increase is due to increased operating efficiencies.
- Liabilities increased \$16,511, which represents a 44.0% increase from 2005. Leases payable decreased by \$9,700, accounts payable increased by \$16,307, and other current liabilities increased by \$9,904.
- Operating revenues increased by \$184,521 which represents a 13.5% increase from 2005. The majority of this increase (\$90,672) is due to increased enrollment resulting in increased state funding and by increases in other revenue (primarily rent and services income).
- Expenses decreased by \$22,324, which represents a 1.4% decrease from 2005. Operating expense decreases are due to a reduction in staffing, services and other expenses delivered from the split into the new middle school.
- Non-operating revenues increased by \$19,853, which represents a 12.0% increase from 2005. This increase is due mostly to increased Federal and State Grants in plus an increase in interest earned and a decrease in private grants.

Using this Financial Report

This report consists of three parts, the Management's Discussion and Analysis, the Financial Statements and the Notes to the Financial Statements. The Financial Statements include a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets and a Statement of Cash Flows.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006
Unaudited

Statement of Net Assets

The Statement of Net Assets looks at how well the school has performed financially from inception through June 30, 2006. This statement includes all of the assets, liabilities and net assets using the accrual basis of accounting, which is the accounting method used by most private-sector companies. This basis of accounting takes into account all revenues earned and expenses incurred during the year, regardless as to when the cash is received or expended.

The following schedule provides a summary of the School's Statement of Net Assets for fiscal years ended June 30, 2006 and 2005.

	2006	2005
Assets		
Cash	\$ 454,049	\$ 291,277
Other Current Assets	112,558	15,931
Security Deposits	6,000	6,000
Capital Assets	47,031	100,830
Total Assets	619,638	414,038
Liabilities		
Current Liabilities	54,023	27,812
Long-Term Liabilities	0	9,700
Total Liabilities	54,023	37,512
Net Assets		
Net Assets	565,615	376,526
Total Liabilities and Net Assets	\$ 619,638	\$ 414,038

Net Assets increased \$189,089, due primarily to increased enrollment. For assets, cash increased \$162,772; due from other governments increased \$18,408; accounts receivable increased \$78,219 and net capital assets decreased \$53,799 from 2005. For liabilities, accounts payable increased \$16,307; due to other governments increased \$12,436; accrued wages and benefits increased \$4,050; deferred revenues decreased \$6,582 and leases payable decreased \$9,700 from 2005.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006
Unaudited

Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets reports operating and non-operating activities for the fiscal year ended June 30, 2006.

The following schedule provides a summary of the School's Statement of Revenues, Expenses and Changes in Net Assets for fiscal years ended June 30, 2006 and 2005.

	<u>2006</u>	<u>2005</u>
Revenues		
Foundation and Assistance Revenues	\$1,411,523	\$1,320,851
Other Operating Revenues	<u>136,218</u>	<u>42,369</u>
Operating Revenues	<u>1,547,741</u>	<u>1,363,220</u>
Interest	5,180	1,783
Federal and State Grants	180,114	162,990
Private Grants and Contributions	<u>0</u>	<u>668</u>
Non-Operating Revenues	<u>185,294</u>	<u>165,441</u>
Total Revenues	<u>1,733,035</u>	<u>1,528,661</u>
Expenses		
Salaries	604,732	616,167
Fringe Benefits	179,167	174,019
Purchased Services	576,866	555,147
Materials and Supplies	94,101	117,785
Capital Outlay	12,430	16,248
Depreciation	60,705	71,685
Other Operating Expenses	<u>15,945</u>	<u>15,219</u>
Total Expenses	<u>1,543,946</u>	<u>1,566,270</u>
Net Income	189,089	(37,609)
Net Assets at Beginning of Year	<u>376,526</u>	<u>414,135</u>
Net Assets at End of Year	<u>\$ 565,615</u>	<u>\$ 376,526</u>

Net Assets increased for fiscal year 2006 and decreased for fiscal year 2005, for a combined net increase. This combined increase is due primarily to increasing revenues from increasing enrollment. Although certain expenditures such as salaries will increase as the number of classes increases other costs remain fixed such as facilities costs resulting in more efficient operations. Additionally, grants have been received to supplement various educational programs and purchase educational equipment.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006
Unaudited

The most significant increases in revenues from 2005 to 2006 are Foundation and Poverty Based Assistance funds which increased \$93,849 due to enrollment and increases in formula amounts. Other Operating Revenue increased \$90,447 due to rent and services provided to the new middle school. Federal and State Grants increased \$17,124 due mainly to increased title allocations. Interest income increased \$3,397 Private Grants and Contributions decreased by \$668.

Most areas of expenses decreased from 2005 to 2006 as a result of the formation of the middle school partially offset by annual increases in operating costs. Salaries and Fringe Benefits decreased \$6,287; Purchased services increased \$21,719 due to additional pupil support services, administrative services and occupancy costs. Materials and Supplies decreased \$23,684 and Capital Outlay decreased \$3,818 due to using text books, classroom supplies, furniture and equipment purchased in the prior year. Depreciation decreased \$10,980 as a direct result of having fully depreciated equipment at the end of fiscal year 2005. Other Operating Expenses increased \$726.

Capital Assets

As of June 30, 2006 the School had \$47,031 invested in computers and office equipment, furniture, equipment and materials, and building improvements (includes mortgage loan fees), net of depreciation. This is a \$100,830 increase from June 30, 2005.

The following schedule provides a summary of the School's Capital Assets as of June 30, 2006 and 2005.

	2006	2005
Capital Assets (net of depreciation)		
Building Improvements	\$ 0	\$ 41,607
Computers and Office Equipment	15,874	23,891
Furniture, Equipment & Materials	31,157	35,332
 Net Capital Assets	 \$ 47,031	 \$ 100,830

For more information on capital assets see the Notes to the Financial Statements.

Current Financial Issues

Lorain Community School opened in the fall of 2001. In its fifth year of operations it has grown from 88 students, nine teaching staff members and expenses of \$598,301 to a total of 203 students, 17 teaching staff members and expenses of \$1,543,946. As the School matures to full enrollment we strive to maintain the high level of services we currently offer, to provide a strong educational product to our students and families and to maintain the reputation we have developed during these initial years.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006
Unaudited

Contacting the School's Financial Management

This financial report is designed to provide our constituents with a general overview of the School's finances and to show the School's accountability for the monies it receives. If you have any questions about this report or need additional information please contact Thomas F. Babb, CPA, Treasurer, at Constellation Community Schools, 3326 Broadview Road, Cleveland, Ohio 44109-3316; by calling 216.635.1881; by faxing 216.635.1883 or by e-mail to babb.thomas@constellationschools.com.

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**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

***Statement of Net Assets
As of June 30, 2006***

Assets:

Current Assets:

Cash	\$454,049
Due from Other Governments	24,839
Accounts Receivable	87,719
	<hr/>
<i>Total Current Assets</i>	566,607

Non-Current Assets:

Security Deposits	6,000
Capital Assets (Net of Accumulated Depreciation)	47,031
	<hr/>
<i>Total Non-Current Assets</i>	53,031

<i>Total Assets</i>	<hr/> <u>\$619,638</u>
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Liabilities:

Current Liabilities:

Accounts Payable	\$27,333
Due Other Governments	12,826
Accrued Wages and Benefits	5,427
Deferred Revenue	8,437
	<hr/>
<i>Total Liabilities</i>	54,023

Net Assets:

Investment in capital assets, net of related debt	47,031
Restricted	30,000
Unrestricted	488,584
	<hr/>
<i>Total Net Assets</i>	<u><u>\$565,615</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

***Statement of Revenues, Expenses and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2006***

Operating Revenues:

Foundation and Poverty Based Assistance Revenues	\$1,411,523
Other Operating Revenues	<u>136,218</u>
<i>Total Operating Revenues</i>	<u>1,547,741</u>

Operating Expenses:

Salaries	604,732
Fringe Benefits	179,167
Purchased Services	576,866
Materials and Supplies	94,101
Capital Outlay	12,430
Depreciation	60,705
Other Operating Expenses	<u>15,945</u>
<i>Total Operating Expenses</i>	<u>1,543,946</u>
Operating Income	<u>3,795</u>

Non-Operating Revenues:

Interest	5,180
Federal and State Grants	<u>180,114</u>
<i>Total Non-Operating Revenues</i>	<u>185,294</u>
Net Income	<u>189,089</u>
Net Assets at Beginning of the Year	<u>376,526</u>
Net Assets at End of Year	<u><u>\$565,615</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

***Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006***

Increase (Decrease) in Cash:

Cash Flows from Operating Activities:

Cash Received from State of Ohio	\$1,424,270
Cash Payments to Suppliers for Goods and Services	(879,908)
Cash Payments to Employees for Services	(600,681)
Other Operating Revenues	<u>81,417</u>
Net Cash Provided by Operating Activities	<u>25,098</u>

Cash Flows from Noncapital Financing Activities:

Federal and State Grants Received	<u>169,401</u>
Net Cash Provided by Noncapital Financing Activities	<u>169,401</u>

Cash Flows from Capital and Related Financing Activities:

Payments for Capital Acquisitions	<u>(36,907)</u>
Net Cash Used for Capital and Related Financing Activities	<u>(36,907)</u>

Cash Flows from Investing Activities:

Interest	<u>5,180</u>
Net Cash Provided by Investing Activities	<u>5,180</u>

Net Increase in Cash	162,772
Cash at Beginning of Year	<u>291,277</u>
Cash at End of Year	<u><u>\$454,049</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

**LORAIN COMMUNITY SCHOOL
LORAIN COUNTY**

***Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006
(Continued)***

**Reconciliation of Operating Income to Net
Cash Provided for Operating Activities:**

Operating Income	<u>\$3,795</u>
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**Adjustments to Reconcile Operating Income to
Net Cash Provided by Operating Activities:**

Depreciation	60,705
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Changes in Assets and Liabilities:

(Increase) in Due from Other Governments	(7,695)
(Increase) in Accounts Receivable	(48,219)
Increase in Accounts Payable	16,308
Increase in Due Other Governments	12,436
Increase in Accrued Wages and Benefits	4,050
(Decrease) in Deferred Revenue	(6,582)
(Decrease) in Leases Payable	<u>(9,700)</u>

Total Adjustments	<u>21,303</u>
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Net Cash Provided by Operating Activities	<u><u>\$25,098</u></u>
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The accompanying notes to the financial statements are an integral part of this statement.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006

I. DESCRIPTION OF THE SCHOOL AND REPORTING ENTITY

Lorain Community School (LCS) is a nonprofit corporation established on August 25, 2000 pursuant to Ohio Revised Code Chapters 3314 and 1702 to maintain and provide a school exclusively for any educational, literary, scientific and related teaching service that qualifies as an exempt organization under §501(c)(3) of the Internal Revenue Code. On November 7, 2001, LCS obtained tax-exempt status with the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code. Management is not aware of any course of action or series of events that have occurred that might adversely affect LCS' tax-exempt status. LCS, which is part of Ohio's education program, is independent of any school district. LCS may sue and be sued, acquire facilities as needed, and contract for any services necessary for the operation of LCS.

LCS was approved for operation under a contract between the Governing Authority and the Ohio Department of Education (the Sponsor) for a period of five years commencing July 1, 2001 and terminating on June 30, 2006. On October 16, 2003 LCS entered into a contract with Lucas County Educational Service Center (LCESC) to have LCESC replace the Ohio Department of Education as their sponsor as required by Sub. HB 364. Under the terms of the contract LCESC will provide sponsorship services for a fee. The Sponsor is responsible for evaluating the performance of the school and has the authority to deny renewal of the contract at its expiration or terminate the contract prior to expiration. See Note XII for further discussion of the sponsor services. The Governing Authority formed an Ohio non-profit corporation, on September 17, 1999 under the name Constellation Community Schools (management company).

LCS operates under a five-member Board of Trustees. The Board is responsible for carrying out the provisions of the contract, which include, but are not limited to, state-mandated provisions regarding student population, curriculum, academic goals, performance standards, admission standards, and qualification of teachers. LCS controls one instructional facility staffed by seventeen certificated full time teaching personnel who provide services to 203 students

LCS entered into an agreement with CCS to provide management services for the fiscal year. See footnote XII for additional information regarding the management company. The board members of LCS were also board members of CCS until June 15, 2006 at which time a separate CCS Board was formed. LCS Board members are also Board members of Old Brooklyn Community School, Parma Community School, Elyria Community School, Westpark Community School, Mansfield Community School, Puritas Community School, Stockyard Community School, Madison Community School, Greater Cleveland Academy for Gifted Students, Lorain Academy for Gifted Students, Lorain Community Middle School, Old Brooklyn Community Middle School, Westpark Community Middle School and Outreach Academy for Children with Disabilities.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

II. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of LCS have been prepared in conformity with generally accepted accounting principles as applied to governmental nonprofit organizations. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. LCS also applies Financial Accounting Standards Board statements and interpretations issued on or before November 30, 1989, provided they do not conflict with or contradict GASB pronouncements. The more significant of LCS' accounting policies are described below.

1. Basis of Presentation

Enterprise accounting is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where it has been decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

2. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by its measurement focus. Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the Statement of Net Assets. Operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. LCS prepares financial statements using the accrual basis of accounting. Revenues resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded when the exchange takes place. Revenues resulting from non-exchange transactions, in which LCS receives value without directly giving equal value in return, such as grants and entitlements, are recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the fiscal year when the resources are required to be used or the fiscal year when the use is first permitted; matching requirements, in which LCS must provide local resources to be used for a specified purpose; and expenditure requirements, in which resources are provided to LCS on a reimbursement basis. Expenses are recognized at the time they are incurred.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

II. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2. Measurement Focus and Basis of Accounting (Continued)

For fiscal year 2006, LCS has implemented GASB Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets for Insurance Recoveries," GASB Statement No. 44, "Economic Condition Reporting: The Statistical Section," and GASB Statement No. 47, "Accounting for Termination Benefits."

GASB Statement No. 42 establishes accounting and financial reporting standards for impairment of capital assets and clarifies and establishes accounting requirements for insurance recoveries.

GASB Statement No. 44 is to improve the understandability and usefulness of the information that State and local governments present as supplementary information in the statistical section.

GASB Statement No. 47 establishes standards of accounting and financial reporting for termination benefits.

The implementation of GASB Statements Nos. 42 and 47 did not materially affect the presentation of the financial statements for the school and GASB Statement No. 44 does not apply to the school.

3. Cash

All monies received by LCS are deposited in demand deposit accounts.

4. Budgetary Process

Pursuant to Ohio Revised Code Chapter 5705.391 LCS prepares and adopts an annual budget which includes estimated revenues and expenditures for the fiscal year and a five year forecast of revenues and expenditures. LCS will from time to time adopt budget revisions as necessary.

5. Due from Other Governments and Accounts Receivable

Moneys due LCS for the year ended June 30, 2006 are recorded as Due from Other Governments and as Accounts Receivable. A current asset for the receivable amount is recorded at the time of the event causing the moneys to be due.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

II. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

6. Capital Assets and Depreciation

Capital assets are capitalized at cost and updated for additions and retirements during the year. Donated capital assets are recorded at their fair market values as of the dates received. LCS does not possess any infrastructure.

Leasehold improvements are also capitalized. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized.

Depreciation of leasehold improvements, computers and office equipment is computed using the straight-line method over their estimated useful lives. Improvements to capital assets are depreciated over the remaining useful lives of the related capital assets. All items with a useful life of one year or greater and a value of \$500 or more are capitalized. Estimated useful lives are as follows:

<u>Capital Asset Classification</u>	<u>Years</u>
Computers and Office Equipment	3
Leasehold Improvements	5
Furniture, Equipment & Materials	10

7. Intergovernmental Revenues

LCS currently participates in the State Foundation Program and the State Poverty Based Assistance Program and the Federal Lunch Reimbursement Program. Revenues received from these programs are recognized as operating revenues in the accounting period in which all eligibility requirements have been met.

Grants and entitlements are recognized as non-operating revenues in the accounting period in which all eligibility requirements have been met.

Amounts awarded under the above named programs for the 2006 school year totaled \$1,591,637.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

II. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

8. Compensated Absences

Vacation is taken in a manner which corresponds with the school calendar, therefore, LCS does not accrue vacation time as a liability.

Sick leave benefits are earned at the rate of one and one-quarter day per month and can be accrued up to a maximum amount of one hundred twenty days. LCS will accept the transfer of sick days from another school district up to the maximum accrual amount. No financial accrual for sick time is made since unused sick time is not paid to employees upon employment termination.

9. Deferred Revenue

Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied. The deferred revenue for LCS consists of material and fees received in the current year which pertain to the next school year.

10. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates.

III. DEPOSITS

At fiscal year end June 30, 2006, the carrying amount of LCS' deposits totaled \$454,049 and its bank balance was \$476,682. Based on the criteria described in GASB Statement No. 40, "Deposit and Investment Risk Disclosure," as of June 30, 2006, \$376,682 of the bank balance was exposed to custodial risk as discussed below, while \$100,000 was covered by the Federal Depository Insurance Corporation.

Custodial credit risk is the risk that in the event of bank failure, LCS will not be able to recover the deposits. All deposits are collateralized with eligible securities in amounts equal to at least 105% of the carrying value of the deposits. Such collateral, as permitted by the Ohio Revised Code, is held in single financial institution collateral pools at the Federal Reserve Banks or at member banks of the federal reserve system, in the name of the respective depository bank and pledged as a pool of collateral against all of the public deposits it holds or as specific collateral held at the Federal Reserve Bank in the name of LCS.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

IV. CAPITAL ASSETS

A summary of capital assets at June 30, 2006 follows:

	<u>Balance</u> <u>6/30/05</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>6/30/06</u>
Capital Assets Being Depreciated:				
Building Improvements	\$145,248	\$0	\$0	\$145,248
Computers/Office Equipment	97,042	6,906	0	103,948
Furniture, Equipment & Materials	<u>41,753</u>	<u>0</u>	<u>0</u>	<u>41,753</u>
Total Capital Assets Being Depreciated:	<u>284,043</u>	<u>6,906</u>	<u>0</u>	<u>290,949</u>
Less Accumulated Depreciation:				
Building Improvements	(103,640)	(41,608)	0	(145,248)
Computers & Office Equip	(73,152)	(14,922)	0	(88,074)
Furniture, Equipment & Materials	<u>(6,421)</u>	<u>(4,175)</u>	<u>0</u>	<u>(10,596)</u>
Total Accumulated Depreciation:	<u>(183,213)</u>	<u>(60,705)</u>	<u>0</u>	<u>(243,918)</u>
Total Capital Assets, Net of Accumulated Depreciation	<u>\$100,830</u>	<u>\$(53,799)</u>	<u>\$0</u>	<u>\$47,031</u>

V. PURCHASED SERVICES

Purchased Services include the following:

Instruction	\$65,965
Pupil Support Services	53,461
Staff Development & Support	16,409
Administrative	202,885
Occupancy Costs	194,374
Food Services	<u>43,773</u>
Total	<u>\$576,867</u>

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

VI. OPERATING LEASES

LCS leases its facilities from Genco Development, Inc. under a five-year lease agreement. This lease was effective July 1, 2001 and expires June 30, 2006. The lease provides LCS with an option to renew for an additional five year term. The rent payable in the option periods will be negotiated at the time of renewal.

On August 15, 2002, LCS and Genco Development, Inc. amended the lease to include an additional area of the building. The amendment is to run concurrently with the remainder of the original lease. The monthly rent for this additional space is \$500. This amendment was replaced by subsequent amendments.

On June 25, 2003, LCS and Genco Development, Inc. amended the lease to include an additional area of the building. The amendment is to run concurrently with the remainder of the original lease. The monthly rent for this additional space is \$2,500 effective August 1, 2003.

On September 8, 2003, LCS and Genco Development, Inc. amended the lease to include an additional area of the building. The amendment is to run concurrently with the remainder of the original lease. The monthly rent for this additional space is \$2,083 effective January 1, 2004.

Total rents paid to Genco Development, Inc during the fiscal year totaled \$151,000.

VII. RISK MANAGEMENT

1. Property and Liability Insurance

LCS is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. For fiscal year 2006, LCS contracted with Cincinnati Insurance Company for all of its' insurance.

General liability is covered at \$2,000,000 single occurrence limit and \$4,000,000 aggregated. Hired and Non-Owned Vehicles are covered at \$500,000 combined single limit of liability. Other coverage includes School Leaders Errors & Omissions, Employee Crime, Sexual Abuse and Misconduct, Electronic Data Processing and Business Interruption.

2. Workers' Compensation

LCS makes premium payments to the Ohio Worker's Compensation System for employee injury coverage. As of June 30, 2006 there have been no claims filed by LCS employees with the Ohio Worker's Compensation System.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

VII. RISK MANAGEMENT (Continued)

3. Employee Medical, Dental, and Life Benefits

LCS provides medical, dental and life insurance benefits to all full time employees. Employees participate in premium payments through pretax payroll deductions. During the current fiscal year the cost for medical insurance benefits was \$80,200.

VIII. DEFINED BENEFIT PENSION PLANS

1. School Employees Retirement System

LCS contributes to the School Employees Retirement System of Ohio (SERS), a cost-sharing multiple-employer defined benefit pension plan. SERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by state statute per Chapter 3309 of the Ohio Revised Code. SERS issues a publicly available, stand-alone financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the School Employees Retirement System, 300 East Broad St., Suite 100, Columbus, Ohio 43215-3746 by calling (800)878-5853 or by visiting the SERS website at ohsers.org.

Plan members are required to contribute 10 percent of their annual covered salary and LCS is required to contribute an actuarially determined rate. The current rate for LCS is 14 percent of annual covered payroll. A portion of LCS' contribution is used to fund pension obligations with the remainder being used to fund health care benefits; for fiscal year 2006, 10.58 percent of annual covered salary was the portion to fund pension obligations. The contribution requirements of plan members and employers are established and may be amended, up to a statutory maximum amount, by the SERS' Retirement Board. LCS' required contribution for pension obligations to SERS for the fiscal years ended June 30, 2006, 2005 and 2004 were \$3,646, \$3,573 and \$3,266. For fiscal year 2006, all required contributions have been paid.

2. State Teachers Retirement System

LCS participates in the State Teachers Retirement System of Ohio (STRS Ohio), a cost-sharing multiple-employer public employee retirement system. STRS Ohio provides retirement and disability benefits to members and death and survivor benefits to beneficiaries. STRS Ohio issues a stand-alone financial report that may be obtained by writing to STRS Ohio, 275 East Broad Street, Columbus, Ohio 43215-3771, by calling (614)227-4090, or by visiting the STRS Ohio web site at www.strsoh.org.

LORAIN COMMUNITY SCHOOL
— A Community School —
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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

VIII. DEFINED BENEFIT PENSION PLANS (Continued)

2. State Teachers Retirement System (Continued)

New members have a choice of three retirement plans, a Defined Benefit (DB) Plan, a Defined Contribution (DC) Plan and a Combined Plan. The DB plan offers an annual retirement allowance based on final average salary times a percentage that varies based on years of service, or an allowance based on member contributions and earned interest matched by STRS Ohio funds divided by an actuarially determined annuity factor. The DC Plan allows members to place all their member contributions and employer contributions equal to 10.5 percent of earned compensation into an investment account. Investment decisions are made by the member. A member is eligible to receive a retirement benefit at age 50 and termination of employment. The Combined Plan offers features of both the DC and the DB Plan. In the Combined Plan, member contributions are invested by the member, and employer contributions are used to fund the defined benefit payment at a reduced level from the regular DB Plan. DC and Combined Plan members will transfer to the Defined Benefit Plan during the fifth year of membership unless they permanently select the DC or Combined Plan. Existing members with less than five years of service credit as of June 30, 2001, were given the option of making a one time irrevocable decision to transfer their account balances from the existing DB Plan into the DC or the Combined Plan. This option expired on December 31, 2001. Benefits are established by Chapter 3307 of the Ohio Revised Code.

A DB or Combined Plan member with five or more years credited service who becomes disabled may qualify for a disability benefit. Eligible spouses and dependents of these active members who die before retirement may qualify for survivor benefits. Members in the DC Plan who become disabled are entitled only to their account balance. If a member dies before retirement benefits begin, the member's designated beneficiary is entitled to receive the member's account balance.

For the fiscal year ended June 30, 2006, plan members were required to contribute 10 percent of their annual covered salary. LCS was required to contribute 14 percent, 13 percent was the portion used to fund pension obligation. For fiscal year 2005, the portion used to fund pension obligations was also 13 percent. Contribution rates are established by the State Teachers Retirement Board, upon recommendations of its consulting actuary, not to exceed statutory maximum rates of 10 percent for members and 14 percent for employers. Chapter 3307 of the Ohio Revised Code provides statutory authority for member and employer contributions.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

VIII. DEFINED BENEFIT PENSION PLANS (Continued)

2. State Teachers Retirement System (Continued)

LCS' required contribution for pension obligations to STRS Ohio for the fiscal years ended June 30, 2006, 2005 and 2004 were \$74,135, \$74,416 and \$55,582. For fiscal year 2006, LCS contributions totaling \$8,056 were overpaid at year end and are reflected in Due from Other Governments in the accompanying financial statements. All other required contributions have been paid.

IX. POST-EMPLOYMENT BENEFITS

LCS provides comprehensive health care benefits to retired teachers and their dependents through the State Teachers Retirement System of Ohio (STRS Ohio) and to retired non-certified employees and their dependents through the School Employees Retirement System (SERS). Benefits include hospitalization, physicians' fees, prescription drugs and partial reimbursement of monthly Medicare premiums. Benefit provisions and the obligations to contribute are established by the Systems based on authority granted by State statute. Both systems are on a pay-as-you-go basis.

All STRS Ohio retirees who participated in the DB or Combined Plans and their dependents are eligible for health care coverage. The STRS Ohio Board has statutory authority over how much, if any, of the health care costs will be absorbed by STRS Ohio. All benefit recipients pay a portion of the health care cost in the form of a monthly premium. By law, the cost of coverage paid from STRS Ohio funds is included in the employer contribution rate, currently 14 percent of covered payroll. For the fiscal year ended June 30, 2006, the STRS Ohio Board allocated employer contributions equal to one percent of covered payroll to the Health Care Stabilization Fund. For LCS, this amount equaled \$5,703 during fiscal 2006.

STRS Ohio pays health care benefits from the Health Care Reserve Fund. At June 30, 2005, (the latest information available) the balance in the Fund was \$3.3 billion. For the year ended June 30, 2005, net health care costs paid by STRS were \$254,780,000 and STRS had 115,395 eligible benefit recipients.

For SERS, coverage is made available to service retirees with ten or more years of qualifying service credit, and to disability and survivor benefit recipients. All retirees and beneficiaries are required to pay a portion of their premiums for health care. The portion is based on years of service, Medicare eligibility and retirement status.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

IX. POST-EMPLOYMENT BENEFITS (Continued)

After the allocation for the basic benefits, the remainder of the employer's 14 percent contribution is allocated to providing health care benefits. For the fiscal year ended June 30, 2006, employer contributions to fund health care benefits were 3.42 percent of covered payroll, compared to 3.43 percent of covered payroll for fiscal year 2005. In addition, SERS levies a surcharge to fund health care benefits equal to 14 percent of the difference between a minimum pay and the member's pay, pro-rated for partial service credit. For fiscal year 2006, the minimum pay was established at \$35,800. However, the surcharge is capped at 2 percent of each employer's SERS salaries. For LCS, the amount contributed to fund health care benefits, including surcharge, during the 2006 fiscal year equaled \$1,697.

The surcharge added to the unallocated portion of the 14 percent employer contribution rate, provides for maintenance of the asset target level of the health care fund. The target level of the health care reserve is 150 percent of the projected claims less premium contributions for the next fiscal year. Expenses for health care for the fiscal year ended June 30, 2005 (the latest information available), were \$178,221,113. At June 30, 2005, SERS had net assets available for health care benefits of \$267.5 million. SERS has 58,123 participants eligible to receive health care benefits.

X. STATE SCHOOL FUNDING DECISION

On December 11, 2002, the Ohio Supreme Court issued its latest opinion regarding the State's school funding plan. The decision reaffirmed earlier decisions that Ohio's current school-funding plan is unconstitutional.

The Supreme Court relinquished jurisdiction over the case and directed "...the Ohio General Assembly to enact a school-funding scheme that is thorough and efficient..."

LCS is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

XI. CONTINGENCIES

1. Grants

LCS received financial assistance from Federal and State agencies in the form of grants. The disbursement of funds received under these programs requires compliance with terms and conditions, specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of LCS. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of LCS at June 30, 2006.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

XI. CONTINGENCIES (Continued)

2. Litigation

A suit was filed in the US District Court, Southern District of Ohio, Western Division on October 6, 2004, which challenges the funding of charter schools under Equal Protection, Due Process and claims violation of a right to vote on the bodies administering public schools. The case is still pending. The effect of this suit, if any, on LCS is not presently determinable.

3. Enrollment FTE

The Ohio Department of Education conducts reviews of enrollment and full-time equivalency (FTE) calculations made by the schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. The conclusions of this review could result in state funding being adjusted. As of the date of this report adjustments to the state funding received during fiscal year 2006 are reflected in the financial statements.

XII. SPONSORSHIP AND MANAGEMENT AGREEMENT

LCS entered into an agreement with Lucas County Educational Service Center (LCESC) to provide sponsorship and oversight services as required by law. The agreement is effective October 16, 2003. Sponsorship fees are calculated as 1% of state funds received by LCS, from the State of Ohio. The total amount due from LCS for fiscal year 2006 was \$14,243 of which \$899 was outstanding as of June 30, 2006.

LCS entered into an agreement with Constellation Community Schools (CCS) to provide legal, financial, and business management services for the fiscal year 2006. The agreement was for a period of one year, effective July 1, 2005. Management fees are calculated as 11% of the Fiscal Year 2006 Foundation payment received by LCS, as reported in the Monthly Community School Foundation Report. The total amount due from LCS for the fiscal year ending June 30, 2006 was \$155,268 of which \$1,300 was overpaid prior to June 30, 2006 and has been credited to the next fiscal year.

In addition LCS is participating in a payroll bonus reserve established through CCS. Payroll bonus reserve fees are calculated as 1% of the Fiscal Year 2006 Foundation payment received by LCS, as reported in the Monthly Community School Foundation Report. The total amount due from LCS for the fiscal year ending June 30, 2006 was \$14,175 of which \$25 was overpaid prior to June 30, 2006 and has been credited to the next fiscal year.

LORAIN COMMUNITY SCHOOL
— A Community School —
LORAIN COUNTY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006
(Continued)

XIII. RELATED PARTIES

The members of the LCS Board of Trustees were also members of Constellation Community Schools until June 15, 2006 at which time a separate CCS Board was formed. LCS contracts with CCS for legal, financial and business management services.

LCS Board members are also Board members of Old Brooklyn Community School, Parma Community School, Elyria Community School, Westpark Community School, Mansfield Community School, Puritas Community School, Stockyard Community School, Madison Community School, Greater Cleveland Academy for Gifted Students, Lorain Academy for Gifted Students, Lorain Community Middle School, Old Brooklyn Community Middle School, Westpark Community Middle School and Outreach Academy for Children with Disabilities.

Effective January 2, 2006, Lorain Community Middle School (LCMS) began operations located in the space leased and occupied by LCS. LCS has charged rent and personnel costs to LCMS totaling \$24,000 and \$55,956 respectively. As of June 30, 2006, LCMS still owes the personnel costs of \$43,906 to LCS. This amount is reported in accounts receivable for LCS.

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Mary Taylor, CPA

Auditor of State

INDEPENDENT ACCOUNTANTS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS

Lorain Community School
Lorain County
201 West Erie Street
Elyria, Ohio 44052

To the Board of Trustees:

We have audited the basic financial statements of the Lorain Community School, Lorain County, Ohio, (the School) as of and for the year ended June 30, 2006, which collectively comprise the School's basic financial statements and have issued our report thereon dated March 22, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting to determine our auditing procedures in order to express our opinion on the financial statements and not to opine on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts material to the financial statements we audited may occur and not be timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider material weaknesses. In a separate letter to the School's management dated March 22, 2007, we reported other matters involving internal control over financial reporting we did not deem reportable conditions.

Compliance and Other Matters

As part of reasonably assuring whether the School's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express an opinion. The results of our tests disclosed no instances of noncompliance or other matters we must report under *Government Auditing Standards*. In a separate letter to the School's management dated March 22, 2007, we reported another matter related to noncompliance we deemed immaterial.

Lorain Community School
Lorain County
Independent Accountants' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Required by *Government Auditing Standards*
Page 2

We intend this report solely for the information and use of the audit committee, management and the Board of Trustees. It is not intended for anyone other than these specified parties.

A handwritten signature in black ink that reads "Mary Taylor". The signature is written in a cursive, flowing style.

Mary Taylor, CPA
Auditor of State

March 22, 2007



Mary Taylor, CPA
Auditor of State

LORAIN COMMUNITY SCHOOL

LORAIN COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
MAY 29, 2007